DRASTIC PLEDGE AGREEMENTS

IN this article are considered: the restrictive safeguards against misuse of the pledge which circumscribed the common law pledgee; to what extent these limitations have been and may be overcome by agreement in the modern instrument of pledge; instances in which broad powers therein conferred have suggested to the grantee opportunities for improper advantage to himself, and how the courts have interposed to prevent fruition of such schemes.

The duties imposed by law on a pledgee, with respect to security left with him, are designed to prevent loss, fraud or oppression.[1] Thus, by way of example, he must keep the pawn and not use it,[2] unless it would be the better for use.[3] He may not sell it before default,[4] and no evidence of custom to the contrary can justify him in so doing;[5] nor may he repledge it.[6]

In early times, the pledge could not be foreclosed except under judicial process,[7] and this rule still prevails in other systems of law.[8] It has long been authoritatively adjudged, however, in our own, that the pledgee, on default, may sell the pledge, without judicial intervention, at public sale;[9] provided, in the case of obligations not maturing at a time certain, he makes demand for payment, and in all cases, also makes demand for redemption,

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[1] Union Trust Co. *v.* Rigdon, 93 Ill. 458, 468–9 (1879).

[2] JONES, COLLATERAL SECURITIES, 3 ed., 598, § 501; Lawrence *v.* Maxwell, 53 N. Y. 19–22 (1873); Union Trust Co. *v.* Rigdon, *supra*, p. 465.

[3] 1 CHITTY'S BL. COMM., 19 London ed., 451 n.

[4] Commonwealth *v.* Althause, 207 Mass. 32, 42, 93 N. E. 202, 204 (1910).

[5] Markham *v.* Jaudon, 41 N. Y. 235 (1869); Oregon, etc. Co. *v.* Hilmers, 20 Fed. 717 (1884).

[6] Warfield *v.* Adams, 215 Mass. 506, 515, 102 N. E. 706, 710 (1913); Skiff *v.* Stoddard, 63 Conn. 198, 218, 26 Atl. 874, 880 (1893); Wood *v.* Fisk, 109 N. E. (N. Y.) 177 (1915).

[7] Cortelyou *v.* Lansing, 2 Caines Cas. (N. Y.) 200, 202 (1805), per Chancellor Kent; Wilson *v.* Little, 1 Sandf. (N. Y.) 351, 357 (1848); Smith *v.* Shippers' Oil Co., 120 La. 640, 658, 45 So. 533, 539 (1907).

[8] Cortelyou *v.* Lansing, *supra*.

[9] Wheeler *v.* Newbould, 16 N. Y. 392, 401–2 (1857); JONES, COLLATERAL SECURITIES, 3 ed., 724, § 602.

giving reasonable notice of time and place of intended sale.[10] But if the debtor cannot be found, or for other reason this demand or notice cannot be given, it is still the law, that the pledge must be realized on through judicial order.[11]

Nor may every species of security be sold, even now. The creditor holding an obligation secured by *choses in action*, such as notes, non-negotiable bonds or mortgages, may sell the principal indebtedness, and the securities will pass with it as an incident. He may not, however, dispose of the *choses in action* apart from the obligation they secure; his duty is to collect them.[12]

Finally, the pledgee, standing in a relation of trust to the pledgor, is affected by the rule that a trustee may not purchase, directly or indirectly, at his own sale.[13]

All this is apt to hamper a desirable use of the pledge and unduly to retard quick collection of the debt. Accordingly, it has become customary to make special contracts removing these disabilities; giving the pledgee the right to use the collateral security as his own, being responsible only for return of a like amount of the kind deposited; allowing public or private sale, free from right of redemption, without demand, notice or advertisement; authorizing the pledgee to bid as any other bidder would, to purchase at market price and to account only for the proceeds obtained, less expenses.[14]

The validity of such instruments will first be considered. As a general rule, such agreements are enforcible to the extent that they

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[10] Franklin Nat. Bank *v.* Newcombe, 1 App. Div. 294, 297–8, 37 N. Y. Supp. 271, 273–4 (1896), per Van Brunt, J.; *affirmed*, 157 N. Y. 699, 51 N. E. 1090 (1898); Chouteau *v.* Allen, 70 Mo. 290 (1879); JONES, COLLATERAL SECURITIES, 3 ed., 728, § 607.

[11] Wheeler *v.* Newbould, 16 N. Y. 392, 400 (1857); Bates *v.* Wiles, 1 Handy (Ohio) 532, 535–6 (1854).

[12] Peacock *v.* Phillips, 247 Ill. 467, 93 N. E. 415 (1910); Wheeler *v.* Newbould, *supra*, pp. 398–9.

[13] Stebbins *v.* Michigan, etc. Truck Co., 212 Fed. 19, 29 (1914); Glidden *v.* Mechanics' Nat. Bank, 53 Oh. St. 588, 599, 42 N. E. 995, 997 (1895); Appleton *v.* Turnbull, 84 Me. 72, 80, 24 Atl. 592, 594 (1891). But, see, Fidelity Ins., etc. Co. *v.* Roanoke Iron Co., 81 Fed. 439 (1896).

[14] For examples of such notes, see, McDougall *v.* Hazelton Tripod-Boiler Co., 88 Fed. 217, 218–9 (1898); Dibert *v.* D'Arcy, 248 Mo. 617, 626–8, 154 S. W. 1116, 1118 (1913); Williams *v.* United States Trust Co., 133 N. Y. 660, 661, 31 N. E. 29 (1892); Smith *v.* Shippers' Oil Co., 120 La. 640, 654, 45 So. 533, 538 (1907); Torrance *v.* Third Nat. Bank of Pittsburgh, 210 Fed. 806–7 (1914).

fairly facilitate collection of the creditor's due.[15] When, however, they provide for a forfeiture of the security, they are, like all other agreements for a penalty, invalid, on grounds of public policy.[16]

But such agreements, even when upheld, are regarded by the courts with suspicion and dislike. Their attitude is thus expressed by Judge Taft:

"A court of equity scrutinizes with great care the contracts made between pledgee and pledgor, as to the transfer of title to the pledgee, and does not hesitate to set aside such a contract if there is any ground for thinking that it is a harsh contract, and one brought about by the position of vantage that the pledgee occupies with reference to the pledgor." [17]

It may be questioned whether this is not too strong a general statement; though correct if applied to the facts in that case, which involved an attempt to require payment of an exorbitant sum for the redemption of securities.

In *Ohio National Bank of Wash.* v. *Central Construction Co.*,[18] a secured note allowing immediate sale on non-payment, or sale within ten days after unsuccessful demand for additional collateral, was described as harsh and incongruous in its provisions,[19] and the intimation was, that giving the right to sell at stock exchange, or own bank, at public or private sale, without notice of any kind, of time, place, or manner of sale, with power in the pledgee to become purchaser, ought to be declared void.[20]

Notwithstanding, however, such agreements may appear in some aspects harsh and drastic, the courts should, and do, attempt to carry out rather than strike down such compacts, preserving the rights of the pledgor by strict construction and by requiring exercise, in his behalf, of the utmost good faith.

Passing, then, from consideration of questions of validity, to inquiry into the justifications for strict construction, one reason given is, that ordinarily the pledgee frames the pledge instrument,

[15] *In re* Mertens, 144 Fed. 818, 821 (1906); *affirmed*, as Hiscock *v.* Varick Bank of New York, 206 U. S. 28, 38 (1907); Farmers' Loan & Trust Co. *v.* Toledo & S. H. R. Co., 54 Fed. 759, 774 (1893).

[16] West *v.* Guaranty Trust Co. of New York, 83 Misc. 609, 145 N. Y. Supp. 634 (1914); Smith *v.* Shippers' Oil Co., 120 La. 640, 658, 45 So. 533, 539 (1907).

[17] Ritchie *v.* McMullen, 79 Fed. 522, 557–8 (1897).

[18] 17 D. C. App. 524 (1901).

[19] *Ibid.*, p. 543.

[20] *Ibid.*, p. 544.

and therefore the general principle that ambiguous words are construed against the user, applies. Bankers and brokers have regular printed forms of "collateral notes" the language of which, if equivocal, is to be read unfavorably to the draftsman.[21] In *Torrance* v. *Third National Bank of Pittsburgh*,[22] the Court, Judge Gray writing the opinion, decided that makers of a joint and several note, pledging security which they owned jointly, for payment of the note, "or any other liabilities of the undersigned . . .", authorized use of the collateral security only for obligations jointly incurred, and hence not in settlement of indebtedness incurred as indorsers. The Court, after saying that the terms of a pledge, "must be construed with a certain measure of strictness,"[23] added that it was for the bank which framed the pledge to have made the meaning insisted upon by it clear "by . . . making the clause read: 'any other liability or liabilities of the undersigned or either of them.'"

A second reason for interpreting such instruments rigorously against the pledgee is, that a trust created and defined by contract will be viewed favorably to the beneficiary.[24] Affecting equities of redemption, it must "be construed benignantly for the debtor — as benignantly for him as may consist with security of the creditors."[25]

Courts not only scan such instruments with great strictness,[26] but are alert to discern a waiver of right to proceed according to the letter of the contract. Mere indulgence may detract from the creditor's rights, and no consideration is necessary for the waiver.[27]

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[21] Union Nat. Bank *v.* Forsyth, 50 La. Ann. 770, 778, 23 So. 917, 920 (1898); Mt. Vernon Refrigerating Co. *v.* Wolf Co., 188 Fed. 164, 168 (1911); writ of *certiorari* refused, 225 U. S. 711 (1912).

[22] 210 Fed. 806 (1914).

[23] *Ibid.*, p. 808.

[24] Dibert *v.* D'Arcy, 248 Mo. 617, 647, 154 S. W. 1116, 1125 (1913).

[25] Sparhawk *v.* Drexel, 22 Fed. Cas. 860, 866 bot. right col. (1874).

[26] For example, see, Smith *v.* Shippers' Oil Co., 120 La. 640, 45 So. 533 (1907), where promise in note was limited by attached agreement respecting collateral; Warfield *v.* Adams, 215 Mass. 506, 102 N. E. 706 (1913), 7th par. syl., holder in collateral agreement confined to first holder. *Contra*, Mulert *v.* National Bank of Tarentum, 210 Fed. 857 (1913); Commonwealth *v.* Althause, 207 Mass. 32, 93 N. E. 202 (1910), right given to "use" collateral security pledged, means, use as pledge, and not to sell, before default. See, also, Kennedy *v.* Broderick, 216 Fed. 137 (1914).

[27] Toplitz *v.* Bauer, 161 N. Y. 325, 331–2, 55 N. E. 1059, 1060–1 (1900); Hill *v.* Alber, 261 Ill. 124, 103 N. E. 612 (1913).

It is to be doubted whether provisions favorable to the pledgee, waived or suspended, can be restored to him, in absence of agreement that waiver of one default shall not be deemed a waiver of successive defaults. The pledgee gets his right to act upon default or within a reasonable time thereafter, and, in the absence of agreement, cannot exercise his power at other times. If the power can be restored to him at all, it must be only upon definite and reasonable notice of intention to avail himself of it.[28]

Supplementary to canons of construction and waiver unfavorable to the pledgee, probably the most important of all the rules enforced in behalf of the pledgor is that requiring of the pledgee the strictest good faith in performance of the agreement on his part, and the insistence that he cannot shelter himself behind a bare literal compliance with the powers conferred, but must exercise them for the benefit of the pledgor as well as for himself.[29] This is particularly true where the pledgee is enabled by agreement to become purchaser. As well expressed in a recent case, he is still "'trustee to sell' not to buy, though with the privilege of buying, if fairly sold." [30]

The foregoing principles of strict construction, waiver and good faith have been variously applied in decisions relating to time, place, advertisement, notice, announcement and method of sale, and obligation of pledgee, when purchaser, to account for full value of securities.

The courts jealously guard the obligor's right to receive effective notice and are astute in finding it to exist, unless it has been taken away in unmistakable terms. Thus, should a pledgee be authorized to sell on default "in the best way he could," this would not relieve him of the duty to exercise the power only upon reasonable notice to redeem and of the time and place of the prospective sale. A mere general notice to the debtor of intention to sell would be insufficient.[31]

Clearly this must be so; since, for the debtor to be present at the sale in person or by agent, is a protection, the benefit of which

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28 Fox *v.* Grange, 261 Ill. 116, 103 N. E. 576 (1913).

29 Turner *v.* Metropolitan Trust Co. of City of New York, 207 Fed. 496, 501 (1913); Bon *v.* Graves, 216 Mass. 440, 446, 103 N. E. 1023, 1026 (1914); King *v.* Boerne State Bank, 159 S. W. (Tex.) 433 (1913).

30 Dibert *v.* Wernicke, 214 Fed. 673, 681 (1914).

31 Goldsmidt *v.* First Methodist Church, 25 Minn. 202 (1878).

such notice would not ensure him. Even if unable himself to buy, knowing with certainty a reasonable period in advance, the exact hour and place of sale, he can attract buyers, or, failing in that, at least make sure that the sale is so conducted that the security will, if it can, pay his debt and realize a sum in addition. As to such possible surplus, the pledgee would represent the pledgor exclusively.[32]

But great as is the value of notice to the pledgor, advertisement and disclosure at the sale are additional safeguards of equal efficacy. Notice to the pledgor brings into play the efforts of which he is capable. Advertisement, and, to a lesser degree, full disclosure at the sale, enlist the aid of the public in his interest. It is not to be presumed that because one of these rights is waived, others equally essential and quite distinct, are also abandoned. Where each is important, nothing is to be taken away by inference. Thus, suppose a bank's form of note authorizes sale without notice and permits the bank to purchase if the sale be public; the bank, purchasing at an unadvertised auction sale, will not have properly acquired title. The pledgor's waiver of notice means notice to him, and there has been no surrender by the pledgor of his right to the general notice or advertisement contemplated by a public sale.[33]

Now what kind of an advertisement must this be? Obviously, one which will accomplish the purpose for which it is intended. A common form consists of a statement in the public press that the sale is "for the account of whom it may concern," describing the security and giving the time, place and manner of sale, supplemented by announcement, if sale is to be had on the stock exchange, that the floor is open at such time to the public. But such notice is not sufficient: it should disclose, also, the principals for whom the property is being sold; that it is being sold to foreclose a pledge, and for a named amount.[34]

This suggestion is usually met with loud outcry from bankers and brokers, who asseverate that such disclosure is not usual and needlessly bares matters they regard as confidential. But their

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[32] Harrison *v.* Friend, 1 N. P. (Ohio) 39, 41 (1893).

[33] Hagan *v.* Continental Nat. Bank, 182 Mo. 319, 327, 342, 81 S. W. 171, 172, 177 (1904); Laclede Nat. Bank *v.* Richardson, 156 Mo. 270, 281, 56 S. W. 1117, 1119 (1900).

[34] Laclede Nat. Bank *v.* Richardson, 156 Mo. 270, 278, 56 S. W. 1117, 1118 (1900).

complaint loses sight of the essential nature of the transaction, which, as before stated, is one involving a relation of trust. If the public is informed that some well known institution or person has taken A's security in pledge, such knowledge helps to excite interest in the sale. If it further appears that a considerable sum has been advanced on the assumed worth of the pledge, this tends to appreciate the value of the pledged security in the eyes of the public. While, of course, the lender may have relied largely on the financial strength of the maker of the obligation and but little on the security, yet the converse may be true, and only by knowing all the facts can the public make up its mind which is probably the case. Notoriety as to who are the parties to the transaction, the amount involved and the security, is more important for the borrower (and perhaps for the lender) than secrecy would be.

Value is, after all, frequently matter of opinion and taking securities in pledge is an expression thereof by an expert. Then, too, so far as value is based on deductions from facts, the public realizes it can obtain from the principals full information respecting the nature of the security which may not be obtainable from the agent or broker conducting the sale. The business convenience of the seller must, therefore, yield to his higher duties as trustee for the bailor. No usage or custom to the contrary may alter the rules of law ensuring a fair sale.

When it comes to the sale itself, a similar oral notice is necessary.[35] Chancellor Walworth, as early as 1844,[36] adduced as additional reason why announcement should be made that the pledge is for a particular debt and the names of pledgor and pledgee given, the fact that if other sales of the same class of security were made at about the same time, the pledgor would thus know which transaction disposed of his; so that, if the price offered were higher, he might have the advantage of it.

There are cases which, at first reading, may seem opposed to the view above stated, respecting necessary disclosures in advertisement and crying of sale, but they do not seem persuasive. Thus, in one,[37] it appeared that the pledgor had known of the bid,

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[35] *Ibid.*, at 156 Mo. 281, 56 S. W. 1119; Dibert *v.* D'Arcy, 248 Mo. 617, 646, 154 S. W. 1116, 1124 (1913); Dibert *v.* Wernicke, 214 Fed. 673, 682 (1914).

[36] Dykers *v.* Allen, 7 Hill (N. Y.) 497, 500 (1844).

[37] Earle *v.* Grant, 14 R. I. 228, 230 (1883).

approved of the sale and waited four years before bringing his bill to redeem. The ground of decision, therefore, really is, that defects in method of sale may be waived by conduct amounting to ratification.

In another case, where broad language was used,[38] a statute provided that sales should be "in the manner and upon notice to the public usual at the place of sale." In view of the statute, the local custom not to make announcement became relevant. Such sporadic and exceptional decisions, however, cannot dim the great lights of fair dealing and frankness.

It scarcely seems necessary to mention that adequately to protect the pledgor the place of sale must be strictly in conformity with the agreement,[39] notice and advertisement, if any are required, and so far as possible, in a public place.[40] For, what does notice avail, if one be misled into attending at the wrong time or place, or be denied entrance? "Public sale" connotes full opportunity for the public to be present.[41] Countenance departures from the standard requirements of a public sale, and it soon ceases to be such, — a difference in degree becomes a difference in kind.

Coming now to a consideration of the time at which a sale may be had, it seems as if some courts had overstepped the limits of proper effort to protect the pledgor and had, by requiring delay, in effect made a new arrangement for the parties. According to a number of cases, the pledgee may not sell at a time unfavorable

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[38] Bell *v.* Mills, 123 Fed. 24, 28 (1903).

[39] In Manning *v.* Heidelbach, 153 App. Div. 790, 793, 138 N. Y. Supp. 750, 753 (1912), a note allowed the pledgee to become buyer at broker's board or public auction. Purchase at a curb sale was declared not within the power and void.

[40] In Laclede Nat. Bank *v.* Richardson, 156 Mo. 270, 277, 56 S. W. 1117, 1118 (1900), advertisement of place of sale was the east door of the court house. A sale conducted by reason of cold inside this door, which was of glass, was declared invalid, although many bidders were present, including a representative of the pledgor (he stating he was there to protest, not to bid).

[41] Hagan *v.* Continental Nat. Bank, 182 Mo. 319, 327, 330, 81 S. W. 171, 172, 173 (1904). Should the instrument allow public or private sale or at broker's board, with permission to pledgee to purchase if at public sale, this would not entitle him to purchase at broker's board, unless at a time when the floor is open to the public. It would seem the result would be no different if the security were one which could be sold only at broker's board, if sold where, or at a time when, the public was not admitted. The power would not in terms be conferred by permission to purchase at public sale. But, see, Sparhawk *v.* Drexel, 22 Fed. Cas. 860, 867 (1874). The case might have been decided on the ground that the sale was ratified. Brown *v.* Ward, 3 Duer (N. Y.) 660 (1854).

to the pledgor, if abundantly secured.[42] These seem opposed to the weight of authority and to correct reasoning.[43] The pledgee, it is true, is trustee for the pledgor; but the trust is defined by the instrument of pledge. It is inequitable that the pledgee should not have satisfaction of his debt when due, and that the pledgor should compel involuntary extension of the loan.[44] Besides, what is abundant security to-day may soon become worthless, and then the pledgee is likely to complain and ask release, because the security was not made to bring its claimed value. The statement in a number of cases and text books, that the sale should not be forced for barely enough money to secure payment of the debt,[45] appears to have originated in a *dictum* in *Sparhawk* v. *Drexel*,[46] as follows:

> "They are not to frustrate any just expectations of a surplus by forcing sales for barely enough money to secure themselves."

But the pledgor, when he makes his agreement, takes into account the possibility of an unfavorable market and of the lender particularly needing reimbursement at such time. The bailor, therefore, has no "just expectations of a surplus," if recourse to sale must then be had. The creditor may, in certain instances, and under certain circumstances should, adjourn the sale;[47] but he is entitled to collect his debt when due, and not obliged to sell from time to time, in the expectation of a rising market. That he is bound to use the same measure of care a prudent man would in selling his own securities, is too broad a statement; it is correct so far as concerns method of sale, limited by the terms

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[42] Muhlenberg *v.* City of Tacoma, 25 Wash. 36, 57, 64 Pac. 925, 932 (1901); Foote *v.* Utah Commercial, etc. Bank, 17 Utah 283, 294, 54 Pac. 104, 106 (1898).

[43] Union Nat. Bank *v.* Forsyth, 50 La. Ann. 770, 777, 23 So. 917, 920 (1898); King & Co. *v.* Insurance Co., 58 Tex. 669, 674 (1883); Williams *v.* United States Trust Co., 133 N. Y. 660, 31 N. E. 29 (1892); Newsome *v.* Davis, 133 Mass. 343, 348 (1882); Whitin *v.* Paul, 13 R. I. 40, 44 (1880).

[44] Franklin Nat. Bank *v.* Newcombe, 1 App. Div. 294, 37 N. Y. Supp. 271 (1896).

[45] Foote *v.* Utah Commercial, etc. Bank, 17 Utah 283, 294, 54 Pac. 104, 106 (1898); Moses *v.* Grainger, 106 Tenn. 7, 11, 58 S. W. 1067, 1068 (1900), quoting COLEBROOK, COLLATERAL SECURITIES, § 118.

[46] 22 Fed. Cas. 860, 867 (1874).

[47] Laclede Nat. Bank *v.* Richardson, 156 Mo. 270, 284, 56 S. W. 1117, 1120 (1900), citing PERRY, TRUSTS; Perkins *v.* Applegate, 27 Ky. L. Rep. 522, 524, 85 S. W. 723, 724 (1905).

of the instrument of pledge, but is not correct if applied to the time when sale is to be had.[48]

In this connection, it is to be said, however, that if the security is divisible without injury, the pledgee should sell no more than may reasonably appear to be enough to satisfy the debt. His duty is to sell in small lots, if (as is usually the case) the security will thus bring a better price.[49] A prospective purchaser may lack means or inclination to bid on a large block of securities and yet offer a considerable sum for a part. Wider competition and attendant higher sale price are thus created. If the pledge is susceptible of sale in small lots, the advertisement, notice and announcement should indicate sale in such manner, with the idea, above suggested, that arousing interest tends to increase what will be realized.

Suppose, now, the pledgee has satisfied all the preceding requisites for proper sale and desires to become a bidder. He must to his own self be true. His duty is at once to bid what he considers the fair value of the pledge.[50] This follows from a just appreciation of the meaning and purpose of an instrument permitting the pledgee to buy. There are times, when, by reason of his intimate knowledge of the worth of the security, or because of his greater financial strength, he would offer more than the bidding public. Under such circumstances, it would be regrettable if he were forced to stand by, because of prohibition to become purchaser, and see the security sacrificed.[51] Frequently, however, the pledgee succumbs to the temptation of getting a bargain at his *cestui's* expense, and, forgetting his duties, instructs his broker or agent to acquire ownership of the pledge, and to do this by beginning to bid at a low figure.

Occasionally this conduct has not met with the reprobation and failure it deserves. Thus, in *Manning* v. *Shriver*,[52] although the

[48] Newsome *v.* Davis, 133 Mass. 343, 347–8 (1882); Exchange State Bank *v.* Taber, 145 Pac. (Idaho) 1090 (1915).

[49] Fitzgerald *v.* Blocher, 32 Ark. 742, 746–8 (1878); Olcott *v.* Bynum, 17 Wall. (U. S.) 44, 62 (1872); Bowen *v.* Bowen, 265 Ill. 638; 107 N. E. 129 (1914). But, see, Newsome *v.* Davis, 133 Mass. 343, 348 (1882).

[50] Dibert *v.* D'Arcy, 248 Mo. 617, 656, 154 S. W. 1116, 1128 (1913).

[51] Turner *v.* Metropolitan Trust Co. of City of New York, 207 Fed. 495, 500 (1913); *In re* Mertens, 144 Fed. 818, 822 (1906).

[52] 79 Md. 41, 43–4, 28 Atl. 899, 900 (1894). See, also, Farmers' Nat. Bank of Annapolis *v.* Venner, 192 Mass. 531, 534, 78 N. E. 540, 541 (1906), where it appeared

pledgee would have offered, under competitive bidding, $7.50 a share, he was able, as sole bidder, to buy the security for a dollar a share. It further appeared that shortly before the sale, the pledgee had offered to surrender the pledgor's note of $2,500.00 on transfer of 350 shares of the stock hypothecated, thus placing his estimate of value at practically $7.50 a share. It was adjudged, nevertheless, that he could not be held to account on the basis of the bid he would have made under competition. This seems wrong and, it is submitted, is not the law. Equity should here, as always, look to the substance and not to the form. The pledgee should account, in absence of acquiescence in the sale by the debtor, for the value of the property; not for what it may have brought.

The cases holding a pledgee responsible for more than his bid are not numerous, but their reasoning is incontrovertible.[53] An interesting analogy is afforded by the recent holdings in the federal courts to the effect that the purchase at judicial sale, by a stockholders' reorganization committee, of the assets of an insolvent corporation at upset price, does not disprove recital of actual and far greater value, when subsequently transferred by the committee to a new corporation.[54]

One or two cases seem to have gone half-way and to have permitted transfer by private sale without notice, after an invalid purchase at public sale, and accounting on the basis of amount received at the private sale.[55] Such a conclusion, where the pledgee is expressly authorized to buy, seems faulty, as authorizing a disposition of the gauge in excess of the power given. This is, to deal with the pledge at public or private sale; the right is to do either, not both; and the true deduction would be, that if the power is once invoked, it is exhausted. Should, however, the relation

that the bank, as sole bidder, bought pledged bonds at a less price than paid in sales shortly before and after the one in question.

[53] Dibert *v.* Wernicke, 214 Fed. 673, 682 (1914); Perkins *v.* Applegate, 27 Ky. L. Rep. 522, 525, 85 S. W. 723, 725 (1905); Phares *v.* Barbour, 49 Ill. 370, 374 (1868); Rush *v.* First Nat. Bank of Kansas City, 71 Fed. 102 (1895), 85 Fed. 539, 543-4 (1898); Sitgreaves *v.* Farmers', etc. Bank, 49 Pa. St. 359, 364 (1865).

[54] Northern Pacific Ry. Co. *v.* Boyd, 228 U. S. 482 (1913); Stebbins *v.* Michigan Wheelbarrow, etc. Co., 212 Fed. 19 (1914); Central Imp. Co. *v.* Cambria Steel Co., 210 Fed. 696 (1913); Investment Registry, Ltd., *v.* Chicago & M. E. R. Co., 212 Fed. 594 (1913); 27 HARV. L. REV. 467, 486. But, see, *In re* Howell, 215 Fed. 1 (1914); Heinze *v.* McKinnon, 205 Fed. 366 (1913).

[55] Hagan *v.* Continental Nat. Bank, 182 Mo. 319, 343, 81 S. W. 171, 178 (1904); Glidden *v.* Mechanics' Nat. Bank, 53 Oh. St. 588, 600, 42 N. E. 995, 998 (1895).

of pledgor and pledgee survive an improper purchase by the pledgee, a later private sale can be had only after all formalities prescribed by law have been complied with.[56]

Mistaking one's rights under an instrument of pledge is sometimes a serious matter. An example is afforded by two recent decisions in different jurisdictions, arising out of the same transaction. A bank pledgee, holder of notes for $45,000.00, secured by the personal obligation of two surety makers, and $90,000.00 of unlisted mortgage bonds of the principal maker, which had been unused except for the purpose of collateral security to the loan, sold the bonds to itself without notice, as sole bidder, on the New Orleans Stock Exchange, for $1,800.00. If necessary to acquire ownership, it would have bid the amount of the debt, or perhaps more. The bank insisted that the sale so made was valid, and, treating the bonds as its own, free from any equity of redemption, transferred them and the note they had secured to a syndicate, whose agent foreclosed the mortgage securing the bonds, bought in the property, and sued the two surety makers, allowing a credit of $1,800.00. Recovery was denied in both instances, under somewhat different processes of reasoning.

In *Dibert* v. *Wernicke*,[57] the surety sued, was given an equitable right of set-off for the real, as opposed to the bid, value of the bonds. The same result was reached by reasoning that the sale of the bonds by the bank to the syndicate under a claim of ownership amounted to a conversion, and that this defense was available to the surety without the necessity of tender, when sued upon the debt.[58] Still another ground for freeing the surety from liability was, that the sale on the Exchange, that to the syndicate, and its subsequent dealings with the security, taken together, constituted such an incumbrance upon his immediate right of subrogation as to discharge him.[59]

In *Dibert* v. *D'Arcy*,[60] a suit by the syndicate agent against the assignee in insolvency of the other surety to compel recognition of the claim on the bonds, the holding was that the bonds would not be treated as issued nor as a debt in excess of the sum they

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56 Leahy *v.* Lobdell, Farwell & Co., 80 Fed. 665, 671 (1897).

57 214 Fed. 673, 682 (1914).

58 *Ibid.*, p. 682.

59 *Ibid.*, p. 684.

60 248 Mo. 617, 658, 662, 154 S. W. 1116, 1128, 1130 (1913).

secured, but only as intended to create a lien to the extent of the principal obligation.[61] It was also held that the syndicate manager would have to account for what he had agreed to bid as the fair value of the property on foreclosure of the mortgage securing the bonds, — an amount exceeding the debt for which he sued.[62]

Both cases held that the sale on the New Orleans Stock Exchange by the bank to itself was invalid, but did not alter the relation of pledgor and pledgee; in other words, that despite the sale, the bank still remained the pledgee. It is submitted, however, that the cases supporting this general conclusion in the event of invalid sale are all instances in which the instrument of pledge did not authorize the pledgee to become purchaser. Where, as in the facts upon which the Dibert cases are based, the instrument authorizes the pledgee to buy, it would seem that such dealing with the pledge would not be void, being made under color of right, but voidable only, and of itself constitute an incumbrance on the surety's immediate right of subrogation, discharging him then and there.

At all events, these cases establish that if the pledgee makes an unauthorized or dishonest sale to himself, and thereafter elects to stand on it, by suing the principal debtor or surety and allowing him credit for the amount realized, or by transferring the security as owner, not pledgee, to a third person, he may, in a case not involving ratification, release the surety, and will be liable to account to the principal maker for the fair value of the securities, or be chargeable with their value as for a conversion.[63]

So, it appears that the "cut throat" instruments of pledge, now in common use, frequently do not accomplish all that their holders desire. The effort to deprive the pledgor of safeguards tending to bring about a fair sale of his property is met by the courts with persistent opposition. Should an instrument be drawn obviating the requirement of notice to the debtor, the necessity of advertising and giving of notice at the sale of amount and nature of the pledge, the parties to it, allowing a sale in bulk of property readily divisible, authorizing the pledgee to bid like any other bidder free

[61] But, see, *contra*, Turner *v.* Metropolitan Trust Co. of City of New York, 207 Fed. 495, 500 (1913).

[62] 248 Mo. 617, 656, 154 S. W. 1116, 1128 (1913).

[63] See, also, Wagner *v.* Kohn, 225 Fed. 718 (1915).

from a trust obligation, and, if purchaser, to account only for the sale price, less expenses, it seems likely that such an instrument would overreach itself and fall into the prohibited class of agreements for a forfeiture.

In conclusion, it will be apparent that the pledgee is bound, at his peril, to exercise the arbitrary powers given in the modern instrument of pledge in the utmost good faith.

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